APPENDIX A — OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT DECIDED JUNE 28, 2006

IN THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Nos. 05-4005, 05-4317

JERRY SUMMERS, *et al.*, individually and on behalf of all others similarly situated,

Plaintiffs-Appellants, Cross-Appellees,

v.

STATE STREET BANK & TRUST COMPANY,

Defendant-Appellee, Cross-Appellant,

and

UAL CORPORATION ESOP COMMITTEE, *et al.*,

Defendants, Cross-Appellees.

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 03 C 1537—Samuel Der-Yeghiayan, *Judge*

ARGUED APRIL 4, 2006—DECIDED JUNE 28, 2006.

Appendix A

Before POSNER, WOOD, and EVANS, Circuit Judges.

POSNER, *Circuit Judge*. At the end of 2002, when United Air Lines declared bankruptcy, its employees (both active and retired) owned more than half the airline's common stock through an ESOP (employee stock ownership plan). *In re UAL Corp.*, 412 F.3d 775, 777 (7th Cir.2005). ESOPs are subject to ERISA, the federal pension law, 29 U.S.C. §§ 1104(a)(2), 1107(b), (d)(6); *Armstrong v. LaSalle Bank National Ass'n*, 446 F.3d 728, 730 (7th Cir.2006), and this is a suit under ERISA. The plaintiffs represent a class consisting of United's employees. The principal defendant is State Street Bank & Trust, a cofiduciary of the UAL Corporation ESOP Committee. The Committee-which has six members, all appointed by the unions that represent United's employees-is the only fiduciary named in the plan. 29 U.S.C. § 1102(a)(1). The plan directs the Committee "to establish an investment policy and objective for the Plan, except that it is understood that the Plan is designed to invest exclusively in Company Stock." The Committee accordingly established a policy and goal of owning United stock, and appointed State Street to be the plan's trustee, that is, to manage the ESOP's assets, initially consisting of that stock. § 1103(a). The class charges State Street with imprudent management—specifically with failing to sell United stock as its market price plummeted en route to the airline's bankruptcy—and is appealing from the grant of summary judgment to State Street, which has in turn cross-appealed on an unrelated issue that we discuss at the end of this opinion.

State Street is what is called a "directed" trustee, because the Committee (the fiduciary named in the plan), in

accordance with the plan language that we have quoted, directed State Street to invest the ESOP's assets exclusively in stock of United Air Lines. Directed trustees are permitted by ERISA: if an ERISA plan "provides that the trustee or trustees are subject to the direction of a named fiduciary [in this case it is the UAL Corporation ESOP Committee] who is not a trustee, . . . the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to [ERISA]." 29 U.S.C. § 1103(a)(1); see *Maniace v. Commerce Bank, N.A.*, 40 F.3d 264, 267 (8th Cir.1994); *May Dept. Stores Co. v. Federal Ins. Co.*, 305 F.3d 597, 599 (7th Cir.2002); *LaLonde v. Textron, Inc.*, 369 F.3d 1, 5 (1st Cir.2004). Like other ERISA trustees, a directed trustee has a statutory duty of prudence. § 1104(a)(1)(B). But as an ESOP fiduciary, he does not have the further (really, the included) duty to diversify the trust assets, § 1104(a)(1)(C)—we call it "included" in the duty of prudence because diversification is normally an essential element of prudent investing by a fiduciary. *Armstrong v. LaSalle Bank National Ass'n, supra,* 446 F.3d at 732. A directed trustee appointed under an ERISA plan does not have that duty because the very purpose of an ESOP is to invest in a single stock, that of the employer of the ESOP's participants.

We must first decide whether a directed trustee of an ESOP has any fiduciary duty with respect to the choice of trust assets, specifically any duty ever to replace the employer's stock-the normal holding of an ESOP-with some other security. The *Maniace* case that we cited, along with *Herman v. NationsBank Trust Co.*, 126 F.3d 1354, 1361-62 (11th Cir.1997), says no, but *FirsTier Bank, N.A. v. Zeller,*

16 F.3d 907, 911 (8th Cir.1994), says yes, as does *In re WorldCom, Inc. ERISA Litigation,* 354 F.Supp.2d 423, 444-45, 449 (S.D.N.Y.2005). The split reflects a confusing statutory picture. One provision of ERISA states that the directed trustee cannot be liable for obeying the directions of the fiduciary named in the plan, § 1105(b)(3)(B), but other provisions impose liability on a fiduciary for breaches of fiduciary duty by a cofiduciary if he knows of the breach and takes no reasonable efforts to prevent it, or if by his own failure to exercise prudence he enables the breach. §§ 1105(a)(2), (3). And recall that the directed trustee "shall be subject to *proper* directions of [the named] fiduciary which are made in accordance with the terms of the plan and *which are not contrary to [ERISA].*" § 1103(a)(1) (emphasis added). An imprudent direction cannot be a proper direction since the trustee has an express statutory duty of prudence.

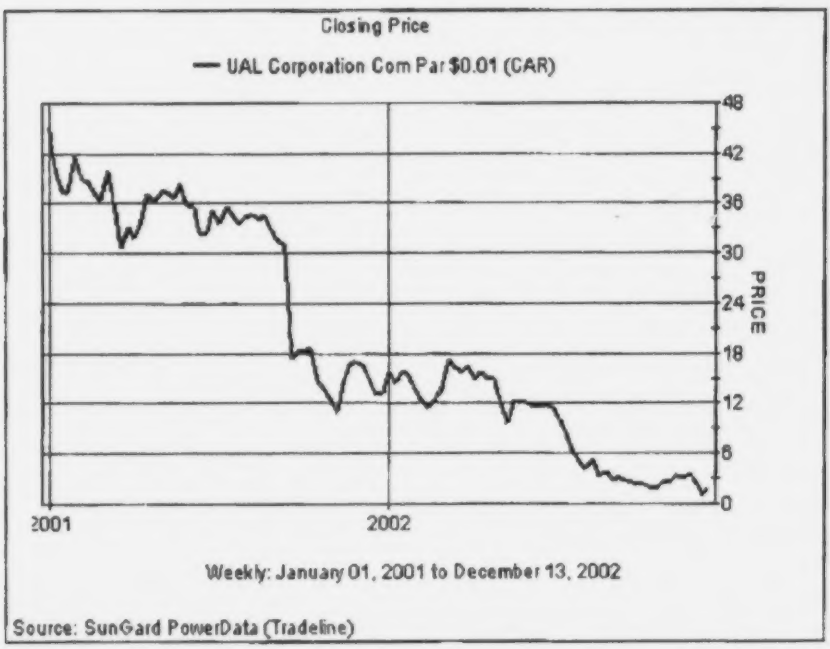
The tension among these provisions is reflected in a pamphlet published by the Labor Department's Employee Benefits Security Administration, which affirms both that the directed trustee has a duty of prudence and that he has no "direct obligation to determine the prudence of a transaction" entrusted by the plan to another fiduciary. "Fiduciary Responsibilities of Directed Trustees" (Field Assistance Bulletin 2004-03, Dec. 17, 2004). "[D]irect" is the critical word, inviting us to resolve the tension by ruling that the trustee can disobey the named fiduciary's directions when it is plain that they are imprudent. (The Labor Department's pamphlet, as we'll see, is actually consistent with this approach.) The trustee physically controls the trust assets; knowingly to invest them imprudently or let them remain invested imprudently is irresponsible behavior for a trustee,

whose fundamental duty is to take as much care with the trust assets as he would take with his own property. He is "an agent who is required to treat his principal with utmost loyalty and care-treat him, indeed, as if the principal were himself." *Pohl v. National Benefits Consultants, Inc.*, 956 F.2d 126, 128-29 (7th Cir.1992). And although the creator of an ordinary trust may be able to include a provision in the trust instrument excusing the trustee from complying with the prudent-man rule, John H. Langbein, "The Contractarian Basis of the Law of Trusts," 105 *Yale L.J.* 625, 659-60 (1995), ERISA as we have seen expressly imposes the duty of prudence on directed trustees and forbids them to comply with directions of the fiduciary named in the plan that are not "proper." That is why *Kuper v. Iovenko*, 66 F.3d 1447, 1457 (6th Cir.1995), holds that an ERISA plan "may not be interpreted to include a per se prohibition against diversifying an ESOP."

Which brings us to the particulars of this case. The plaintiffs argue that State Street violated its fiduciary duty by failing to sell United stock held by the ESOP until the eve of United's bankruptcy. State Street knew long before then, if the plaintiffs are to be believed, that the UAL Corporation ESOP Committee, the named fiduciary, had unreasonably refused to deviate from the plan and diversify the ESOP's holdings or take other measures to reduce the looming risk to the employee-shareholders. The following chart traces the ups and downs (mostly downs) of United's

Appendix A

stock price between January 1, 2001, and December 9, 2002, when United declared bankruptcy:



Appendix A

The price of United stock, which on September 10, 2001, was already 25 percent below the price at the beginning of the year, dropped almost 50 percent more in the immediate aftermath of the September 11, 2001, terrorist attacks. The following month, United's CEO sent a gloomy letter to all its employees which said that the company was "in a struggle just to survive" and was not yet in "a financial position that will allow us to continue operating," that it was "hemorrhaging money," and unless the "bleeding [was] stopped . . . United will perish sometime next year." The price of United stock fell another 20 percent in the two days after the publication of the letter.

The price continued falling, though with occasional upticks, and the financial press began speculating on the possibility of bankruptcy. State Street observed the decline with anxiety, but not until August 15, 2002-by which time the price had fallen to $2.70-did it notify the UAL Corporation ESOP Committee that it might be imprudent for the ESOP to continue holding United stock. In response to this warning the Committee authorized State Street to sell the stock, and it began doing so on September 27. By that time, however, the price had fallen to $2.36. The plaintiffs argue that State Street should have started selling within 30 days after the October 2001 letter of United's then-CEO and that had it done so the ESOP would have avoided $540 million in losses.

The plaintiffs say the letter should have alerted State Street that United was going into the tank. That is wrong. After the market "read" the letter, it valued United stock at $15.05 a share. Had the market thought that United would

be bankrupt by the end of 2002, it would not have priced its stock that high in October 2001, implying a market capitalization for the company of more than $800 million. A trustee is not imprudent to assume that a major stock market (United was traded on the New York Stock Exchange) provides the best estimate of the value of the stocks traded on it that is available to him. *In re UAL Corp., supra,* 412 F.3d at 777-78; see *Basic Inc. v. Levinson,* 485 U.S. 224, 247, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988); *In re Hovis,* 356 F.3d 820, 823-24 (7th Cir.2004); *Feder v. Electronic Data Systems Corp.,* 429 F.3d 125, 138 (5th Cir.2005); Burton G. Malkiel, "Reflections on the Efficient Market Hypothesis: 30 Years Later," 40 *Financial Rev.* 1 (2005). At *any* price at which a sale takes place, the buyer thinks he's getting a bargain, or at least a reasonable deal-otherwise he wouldn't buy. Some investors, it is true, consistently beat the market, but few of them are trustees; it would be *hubris* for a trust company like State Street to think it could predict United's future more accurately than the market could, and preposterous for a committee of union officials (the named fiduciary) to challenge the market's valuation. Nor was State Street duty-bound to offer the Committee's members a tutorial on the obligations of an ERISA trustee; the Committee had its own lawyers for that.

Thus, at *every* point in the long slide of United's stock price, that price was the best estimate available either to State Street or to the Committee of the company's value, *In re UAL Corp., supra,* 412 F.3d at 777-78, and so neither fiduciary was required to act on the assumption that the market was overvaluing United. See *Wright v. Oregon Metallurgical Corp.,* 360 F.3d 1090, 1099 (9th Cir.2004);

Appendix A

Kuper v. Iovenko, supra, 66 F.3d at 1460; *In re WorldCom, Inc. ERISA Litigation, supra*, 354 F.Supp.2d at 447. What is true, however, though largely (and fatally) ignored by the plaintiffs and mistakenly denied by State Street's lawyers in this court (State Street itself we assume knows better), is that the fall in the market price of United was increasing the risk borne by the owners of the stock, the participants in the ESOP. There is always risk, in the sense of variance of returns, to owning common stock, because the fortunes of a company are uncertain and the stockholders, unlike bondholders and other owners of the company's debt, do not have a fixed entitlement; they are the residual risk bearers. Some companies, however, are riskier than others. Of particular relevance to this case, the higher the ratio of fixed-interest debt to equity is, the riskier is the position of the equity holders (the common stockholders). If a company has no debt, a 5 percent increase in the company's value will increase shareholder equity by 5 percent, and a 5 percent decrease in the company's value will decrease shareholder equity by 5 percent. But if the company has a 1:1 debt-equity ratio, a 5 percent increase in the company's value will increase shareholder equity by 10 percent (.05/.50) and a 5 percent decrease in the company's value will decrease shareholder equity by 10 percent. As the value of United, as reckoned by the stock market, plummeted, the airline's debt-equity ratio soared because its debt wasn't decreasing, and this created an acute threat of bankruptcy.

Such a threat would be of little moment to people who held United stock as part of a diversified portfolio, because the risks of the various components of such a portfolio tend to cancel out; that is the meaning and objective of

diversification. *The Modern Theory of Corporate Finance* 6 (Clifford W. Smith, Jr., ed., 2d ed.1990). Probably, however, shares of United stock were the principal financial assets of most of United's employee-shareholders-at least those who, unlike pilots, have modest salaries-and hence their principal source of retirement income. And probably most of those non-wealthy employee-shareholders were risk averse; that is, they would prefer $10,000 certain to a 1 percent chance of obtaining $1 million, even though these are actuarial equivalents. They would be especially risk averse with regard to provision for their retirement, where they would be more dependent on their financial assets since they would no longer have earned income. Being risk averse, they would have preferred that the bulk of their financial assets not be invested in a single stock that, while worth as much as its market valuation (as far as anyone not possessing inside information could know), was extremely risky. "Because the value of any single stock or bond is tied to the fortunes of one company, holding a single kind of stock or bond is very risky. By contrast, people who hold a diverse portfolio of stocks and bonds face less risk because they have only a small stake in each company." N. Gregory Mankiw, *Principles of Economics* 546 (1998). That is why ERISA fiduciaries have a duty of diversification as part of their overall duty of prudence-unless as in this case they are directed pursuant to an ESOP to invest everything in stock of the participants' employer.

The employee-shareholders' total wealth included not only their stake in the ESOP but also-and for those not yet retired or approaching retirement this was probably more important-their expected earnings and fringe benefits as

employees of United. The financial distress that pushed United's stock price down also jeopardized that expected wealth (insofar as United employees could not expect to land equally good jobs at other companies) and so depressed the employee-shareholders' overall wealth by more than the fall in the price of the stock. Brett McDonnell, "ESOP's Failures: Fiduciary Duties When Managers of Employee-Owned Companies Vote to Entrench Themselves," 2000 *Colum. Bus. L.Rev.* 199, 207 (2000). State Street's lawyers thus miss the point in arguing that American Airlines was on the verge of bankruptcy too but managed to avoid it and so might United have done so. Someone who owned American Airlines stock, and would have wanted but was unable to diversify, would have been bearing unwanted risk during American's period of peril.

But because an ESOP is at once a permissible form of ERISA trust and nondiversified by definition, the trustee (along with the named fiduciary) is in an awkward position. If he diversifies he violates the plan, but if he doesn't diversify he may be imposing unwanted risk on the employee-shareholders-for it is unrealistic to suppose that the ESOP form was chosen because the employees *wanted* to bear unnecessary risk. The goal of an ESOP is to give employees not the thrills of gambling but a larger stake in the company's fortunes, see, e.g., *United States v. McCord*, 33 F.3d 1434, 1440 n. 6 (5th Cir.1994), in hopes of "broadening ownership of capital within a capitalist system" to the end of "encouraging capital formation through an improved form of finance, improved management-labor relations, and increased productivity." McDonnell, *supra*, at 220-21. *Why* Congress thought it appropriate to stimulate the adoption

of this business form by giving companies tax breaks rather than allowing the free market to determine the merits of the form is a separate question but not one we need answer in order to decide this case, although it is pertinent to note that one of the goals *not* sought to be achieved by the ESOP form is the funding of pension benefits. Michael A. Conte & Jan Svejnar, "The Performance Effects of Employee Ownership Plans," in *Paying for Productivity* 143, 143-44 (Alan S. Blinder ed.1990). It is a goal that the form is ill suited to attain because of its underdiversification.

The tension between the goal of protection against risk and the goal of a portfolio dominated by a single stock is not acute if the participants in the ESOP have adequate sources of income or wealth that are not correlated with the risk of that stock, so that the ESOP is not their primary financial asset. But if they don't have substantial other wealth the goals cannot be reconciled, though they can be compromised by requiring fiduciaries to begin diversifying the ESOP's assets at the point at which an increase in the riskiness of the assets, had it been foreseen, would have induced the creators of the ESOP either to have not created it at all or to have required at least partial diversification. (We say *begin* diversifying because if the stock held by the ESOP is a very large fraction of the outstanding stock of the employer, as in this case, the sell-off would have to be gradual in order to avoid precipitating a sharp drop in price, Louis K. Chan & Josef Lakonishok, "The Behavior of Stock Prices Around Institutional Trades," 50 *J. Finance* 1147, 1147-48 (1995); the market does not treat the stocks of different companies as being perfectly substitutable. Thus, State Street had a policy of limiting any day's sales of a given stock to 30

percent of the volume of sales that day.) Or, as *Kuper v. Iovenko, supra,* 66 F.3d at 1459, puts it, "the plaintiff must show that the ERISA fiduciary could not have reasonably believed that the plan's drafters would have intended under the circumstances that he continue to comply with the ESOP's direction that he invest exclusively in employer securities." See also *Moench v. Robertson,* 62 F.3d 553, 571-72 (3d Cir.1995).

In *Steinman v. Hicks,* 352 F.3d 1101 (7th Cir.2003), we noted a situation in which the duty of prudence could require diversification of an ESOP's holdings: if the "ESOP was [the employees'] principal retirement asset ... and was entirely invested in the stock of their employer ..., and their employer was bought in a stock-for-stock deal-so that all the assets of the ESOP became stock in the acquirer by a company that had a much higher debt-equity ratio than their (former) employer and as a result its stock price was much more volatile and its bankruptcy risk greater. Then, *even if the trustees did not predict the company's 'impending collapse,'* they might be required in the interest of the participants either to diversify the plan's stockholdings or to exchange the ... stock for Treasury bills." *Id.* at 1106 (emphasis added, citation deleted). The source of the duty to diversify would not be the trustees disagreement with the market valuation (their failure to predict the company's impending collapse), but the excessive risk imposed on employee-shareholders by the rise in the debt-equity ratio of the employer's stock as a result, in the example given in *Steinman,* of a merger and in our case of a plummeting stock price. How excessive would depend in the first instance on the amount and character of the employees' other assets, for, as we have already indicated,

it is the riskiness of one's portfolio, not of a particular asset in the portfolio, that is important to the risk-averse investor.

The plaintiffs never sought to explore these issues. So even if the methods of litigation could feasibly determine the point at which the ESOP trustee should sell in order to protect the employee-shareholders against excessive risk, the plaintiffs have made no effort to establish that point. They think that what State Street did wrong was to fail to second-guess the market; in fact what State Street may well have done wrong was to delay selling its United stock until too late to spare the employee-shareholders from bearing inordinate risk. Of course, if State Street had sold earlier and the stock had then bounced back, as American Airlines' stock did, State Street might well have been sued by the same plaintiffs, though the analysis presented in this opinion would have bailed it out.

There has thus been a failure of proof. But the plaintiffs can take some solace from the fact that determining the "right" point, or even range of "right" points, for an ESOP fiduciary to break the plan and start diversifying may be beyond the practical capacity of the courts to determine. The Department of Labor pamphlet that we cited earlier states that a directed trustee may have a duty to sell "where there are clear and compelling public indicators, as evidenced by an 8-K filing with the Securities and Exchange Commission (SEC), a bankruptcy filing or similar public indicator, that call into serious question a company's viability as a going concern." U.S. Dept. of Labor, *supra,* at 5-6. That is not an administrable standard; note the hedge in "may" and the fact that selling when bankruptcy is declared will almost certainly be too late.

Appendix A

The time may have come to rethink the concept of an ESOP, a seemingly inefficient method of wealth accumulation by employees because of the underdiversification to which it conduces (though remember that what is important is the diversification of the employee's entire asset portfolio, including his earning capacity, rather than whether an individual asset is diversified). The tax advantages of the form do not represent a social benefit, but merely a shift of tax burdens to other taxpayers. Nor are we aware of an argument for subsidizing the ESOP form, as the tax law does, rather than letting the market decide whether it has economic advantages over alternative forms of business structure. As for the notion that having a stake in one's employer will induce one to be more productive, the evidence for such an effect-see "Motivating Employees with Stock and Involvement," *NBER Website*, Apr. 25, 2006, http:// www.nber.org /digest/may04/ w10177.html; Joseph Blasi, Michael Conte & Douglas Kruse, "Employee Stock Ownership and Corporate Performance Among Public Companies," *50 Indus. & Lab. Rel. Rev.* 60 (1996)-is weak and makes no theoretical sense. An employee has no incentive to work harder just because he owns stock in his employer, since his efforts, unless he is a senior executive, are unlikely to move the price of the stock. Nor is employee stock ownership likely to forge sentimental ties between employees and employers that might cause the former to work harder, although it may alleviate union pressures for wages or benefits that would jeopardize solvency.

A second ground of appeal argued by the plaintiffs is that the district judge should not have prevented their expert witness, Lucian Morrison, from testifying about State Street's

prudence or lack thereof in failing to sell United stock sooner. The judge thought Morrison unqualified because he lacks either a degree in economics or experience with bankruptcy. That was error. Morrison is a highly experienced trust officer and as such qualified to testify about State Street's management of the assets of the United ESOP. "Rule 702 [of the Federal Rules of Evidence] specifically contemplates the admission of testimony by experts whose knowledge is based on experience." *Walker v. Soo Line R.R.*, 208 F.3d 581, 591 (7th Cir.2000); see also *Smith v. Ford Motor Co.*, 215 F.3d 713, 718 (7th Cir.2000); *Hangarter v. Provident Life & Accident Ins. Co.*, 373 F.3d 998, 1015-16 (9th Cir.2004). But the error is harmless. Morrison was planning to testify that State Street should have seen the handwriting on the wall back in October or, at the latest, November of 2001. That is an echo of the argument by the plaintiffs' lawyers that State Street should have outsmarted the market and is not a correct interpretation of the duty of prudent management of trust funds, whatever a trust officer might think.

State Street has filed a contingent cross-appeal, challenging a settlement between the plaintiffs and its cofiduciary, the UAL Corporation ESOP Committee. Since we are affirming the dismissal of the plaintiffs' claim against State Street, there is no imperative need to discuss the cross-appeal; it is academic unless this court sitting en banc, or the Supreme Court, reverses our decision in favor of State Street. But the oddity of the situation presented by that appeal calls for some comment. The Committee's members were insured, and the settlement gives the plaintiffs $5.2 million, the limit of the insurance policy after deduction of incurred and expected legal expenses. The settlement provides that if

Appendix A

State Street is determined to be liable for some amount of damages, the judge shall determine its fault relative to the Committee's and State Street may then seek contribution from the Committee's members. Suppose that State Street was ordered to pay the plaintiffs $540 million and the judge decided that it and the Committee were equally at fault. Then State Street would be entitled to a contribution of $264.8 million ($540 / 2 = $270-$5.2 = $264.8) from the Committee. But the Committee's members, we are told by their lawyer, have no assets beyond the insurance policy out of which to satisfy a judgment. This is probably an exaggeration, but a slight one. Suppose improbably that the six members have a total of $4.8 million in personal assets that might be used to satisfy a judgment. Then State Street, even though adjudged only 50 percent responsible for the (supposed) wrongful injury to the plaintiffs, would have to pay almost the entire judgment-$530 million ($270 million + $270 million-$ 5.2 million (paid by insurance company)-$4.8 million (paid by the Committee members) = $530 million) out of $540 million.

The judge in approving the settlement entered an order in effect barring State Street from seeking anything from the Committee members beyond what personal assets they may have. The judge gave no reason for this action; if we may judge from the arguments of the parties' lawyers, either he thought this result "fair" or, as argued by the plaintiffs' lawyer, thought it would make no difference because State Street could in no event obtain from the Committee members money they don't have. But if this is what the judge thought, he was wrong. The members' unions have agreed to indemnify them. Therefore if State Street obtained a judgment

of $264.8 million (in our example) against the members, the unions would have to pay so much of that judgment as they, not the Committee members, could afford. (So we're surprised that the union has not sought to intervene in the suit.)

The problem for which bar orders or, as they are sometimes called, "settlement bars" are a suggested solution was explained recently in *Denney v. Deutsche Bank AG,* 443 F.3d 253, 273 (2d Cir.2006): "If a nonsettling defendant against whom a judgment had been entered were allowed to seek payment from a defendant who had settled, then settlement would not bring the latter much peace of mind. He would remain potentially liable to a nonsettling defendant for an amount by which a judgment against a nonsettling defendant exceeded a nonsettling defendant's proportionate fault. This potential liability would surely diminish the incentive to settle." But to the extent that the nonsettling defendant has a valid claim for contribution from the settling defendant, a bar order that extinguished that claim would encourage a race to settle (to the arbitrary disadvantage of the defendants as a group), since each settling defendant's liability would be capped at the amount of his settlement. This court, in a case not cited by the district judge, has declined to adopt the settlement-bar approach on the ground that the hearing necessary to determine the value of the nonsettling defendant's contribution claim would be cumbersome and therefore costly, and "as the costs of settlement rise closer to those of trial, the likelihood of settlement falls-maybe far enough to offset the incentive to settle that a defendant has who knows that settling will enable him to avoid all liability to the other tortfeasors." *Donovan v. Robbins,* 752 F.2d 1170, 1181 (7th Cir.1985).

The settlement-bar approach assumes, moreover, that there is a right of contribution, and it is unsettled whether ERISA defendants have such a right. *Lumpkin v. Envirodyne Industries, Inc.*, 933 F.2d 449, 464 n. 10 (7th Cir.1991); compare *Chemung Canal Trust Co. v. Sovran Bank/ Maryland*, 939 F.2d 12, 16-17 (2d Cir.1991) (yes, contribution), with *Kim v. Fujikawa*, 871 F.2d 1427, 1432-33 (9th Cir.1989) (no). We assumed in *Alton Memorial Hospital v. Metropolitan Life Ins. Co.*, 656 F.2d 245, 250 (7th Cir.1981), that they do, but did not actually discuss the question, which remains an open one in this circuit. This is not the case in which to close it, as it would not affect our result; we mention it merely in the hope of heading off such errors in the future.

The judgment in No. 05-4005 is affirmed, and appeal No. 05-4317 is dismissed.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

APPENDIX B — MEMORANDUM OPINION OF THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION DATED AND FILED OCTOBER 12, 2005

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

No. 03 C 1537

JERRY R. SUMMERS and GEORGE T. LENORMAND, individually and on behalf of all others similarly situated,

Plaintiffs,

v.

UAL CORPORATION ESOP COMMITTEE, MARTY TORRES, BARRY WILSON, DOUG WALSH, IRA LEVY, DON CLEMENTS, CRAIG MUSA and STATE STREET BANK & TRUST COMPANY,

Defendants.

MEMORANDUM OPINION

SAMUEL DER-YEGHIAYAN, District Judge

This matter is before the court on the parties' motions for summary judgment and on Defendant State Street Bank and Trust Company's ("State Street") motion to exclude Plaintiffs' expert opinions and testimony. For the reasons stated below, we deny Plaintiffs' partial motion for summary

judgment, grant State Street's motion for summary judgment, and grant State Street's motion to exclude Plaintiffs' expert testimony.

BACKGROUND

Plaintiffs were all participants in the United Airlines Corporation Employee Stock Ownership Plan ("Plan"). According to Plaintiffs, United Airlines ("UAL") was in financial trouble in July 2001, and after September 2001, UAL's financial position worsened. Plaintiffs claim that from August 2001 to August 2002, UAL stock prices fell over 80 percent in value. Plaintiffs contend that until August 2002, neither Defendant UAL Corporation ESOP Committee ("Committee"), the named fiduciary of the Plan, nor Defendant State Street, the trustee of the plan, took appropriate actions to protect the Plan assets by diversifying the stock held by the Plan. It is further alleged by Plaintiffs that the Committee members were not aware of the fiduciary duties they owed to the Plan. In August 2002, UAL announced that it might seek bankruptcy protection.

According to Plaintiffs, in September 2002, State Street notified the Committee of its fiduciary duties and nine days later, on September 27, 2002, the Committee began selling the Plan's UAL stock. Plaintiffs claim that by September 27, 2002, the UAL stock had already dropped to $2.36 per share and the Plan had already lost approximately two billion dollars as a result of the decrease in the value of the stock. UAL subsequently filed for bankruptcy. UAL and the individual committee member Defendants have entered into a settlement agreement in this action and State Street remains

as an active Defendant. Plaintiffs have filed a partial motion for summary judgment and State Street has filed a motion for summary judgment.

LEGAL STANDARD

Summary judgment is appropriate when the record, viewed in the light most favorable to the non-moving party, reveals that there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). In seeking a grant of summary judgment, the moving party must identify "those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,' which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986) (quoting Fed.R.Civ.P. 56(c)). This initial burden may be satisfied by presenting specific evidence on a particular issue or by pointing out "an absence of evidence to support the non-moving party's case." *Id.* at 325. Once the movant has met this burden, the non-moving party cannot simply rest on the allegations in the pleadings, but, "by affidavits or as otherwise provided for in [Rule 56], must set forth specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e). A "genuine issue" in the context of a motion for summary judgment is not simply a "metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). Rather, a genuine issue of material fact exists when "the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*,

477 U.S. 242, 248, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); *Insolia v. Philip Morris, Inc.*, 216 F.3d 596, 599 (7th Cir.2000). The court must consider the record as a whole, in the light most favorable to the non-moving party, and draw all reasonable inferences that favor the non-moving party. *Anderson*, 477 U.S. at 255; *Bay v. Cassens Transport Co.*, 212 F.3d 969, 972 (7th Cir.2000).

DISCUSSION

I. Opinions and Testimony of Lucian Morrison

State Street moves to strike or exclude the opinions and testimony of Plaintiffs' expert witness Lucian Morrison ("Morrison"). Federal Rule of Evidence 702 provides the following:

> If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case.

Fed.R.Evid. 702. A court in evaluating expert testimony must apply the *Daubert* analysis. *Durkin v. Equifax Check Services, Inc.*, 406 F.3d 410, 420 (7 Cir.2005). Under such an analysis,

the court must first assess the reliability of the expert's testimony, considering whether "the proposed witness would testify to valid scientific, technical, or other specialized knowledge." *Id.* Secondly, the court must assess the relevance of the expert's testimony, considering whether the "testimony will assist the trier of fact." *Id.*; *see also Fuesting v. Zimmer, Inc.*, 421 F.3d 528, 535 (7 Cir.2005)(stating that an examination of an expert's credentials to determine if he possesses sufficient knowledge, skill, experience, training, or education is not in and of itself a sufficient analysis and that the "district court must also, in keeping with its gatekeeper's duty, assess the reliability of the *methodology* the expert has employed in arriving at his opinion"). Thus, the district court acts as a "gatekeeper with respect to testimony proffered under Rule 702 to ensure that the testimony is sufficiently reliable to qualify for admission." *Mihailovich v. Laatsch*, 359 F.3d 892, 918 (7 Cir.2004). In determining whether expert testimony is admissible, the court should also consider the following non-exhaustive list of factors: "(1) whether the theoretical framework or technique underlying the witness's testimony . . . is subject to verification through testing, (2) whether it has been subjected to peer review and publication, (3) what its known or potential rate of error is, (4) whether there are standards controlling its application, and (5) whether it is generally accepted within the relevant expert community." *Id.*

In the instant action, Plaintiffs seek to offer Morrison's opinion that UAL's bankruptcy was imminent in October 2001, and that Defendants failed to act prudently by neglecting to sell the UAL stock to protect the interests of the Plan participants. Morrison has prior experience acting

as a professional fiduciary and has managed bank and trust activities when working for several banking and trust companies. He has also served as a trustee for employee benefit plans. However, State Street correctly points out that Morrison's opinions range far beyond the proper actions of a fiduciary and delve into areas of bankruptcy, insolvency, economics, and the securities industry. Plaintiffs have not shown that Morrison possesses the requisite "knowledge, skill, experience, training, or education" in such specialized areas. Fed.R.Evid. 702. The bankruptcy of UAL and its surrounding circumstances are key factors in assessing State Street's actions. Morrison is wholly deficient to offer expert testimony regarding such matters. Although he has some experience that has touched on the areas of economics, the securities industry, and corporate bankruptcies, such experience is not sufficient to qualify him as an expert in such areas. The bankruptcy of UAL is such an integral part of the claims in the instant action that a complete and thorough understanding of such matters is crucial to making any sort of informed testimony concerning the propriety of Defendants' actions.

Morrison's lack of expertise in bankruptcy matters and related matters is illustrated by the deficiency in his methodologies utilized in forming his opinions in the instant action. Morrison attempts to sidestep the necessary detailed expert analysis of UAL's financial condition by relying on external factors and extraneous evidence, such as statements made in a letter by UAL's CEO. The trier of fact can read and analyze such letters without the assistance of an expert, and Morrison's speculation based on such evidence is nothing more than a guess. Morrison has not shown to the court that

he utilized any reliable tests or methodologies to support his opinions. Morrison has not shown, for example, that he has utilized a methodology commonly employed by experts in analyzing bankruptcy situations. Morrison did not conduct a financial analysis of UAL's books or apply any reliable methodology in arriving at his opinions. Instead, Morrison offers his own unsupported theories and conclusions, and offers nothing of benefit to the trier of fact. The trier of fact is presumed to be able to think and reason on its own. An expert is not employed in litigation to "think" for the trier of fact. Rather, an expert may only assist the trier of fact in its understanding of the facts and issues at hand. So called "experts" such as Morrison are not entitled to weigh in with their half-baked opinions in order to attempt to sway the trier of fact in its analysis.

Plaintiffs apparently recognize the impropriety of offering Morrison as an expert and, in an effort to salvage at least some of Morrison's testimony, Plaintiffs ask the court to not engage in a "wholesale exclusion" of Morrison's testimony. (Ans.Excl.13). However, we agree with State Street that Morrison's opinions offer virtually nothing to the trier of fact and his uneducated speculation presented under the cloak of an "expert" would only be prejudicial to State Street. Although Morrison claims to have experience and training in certain basic areas that are the focus of the instant action, his lack of expertise in such areas renders all of his conclusions suspect. Therefore, we grant State Street's motion to exclude the opinions and testimony of Morrison.

Appendix B

II. State Street's Motion For Summary Judgment

State Street moves for summary judgment on all claims brought against it. To start, the fiduciary duties under ERISA are explained in 29 U.S.C. § 1104, which provides the following:

> (a) Prudent man standard of care
>
> (1) Subject to sections 1103(c) and (d), 1342, and 1344 of this title, a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and--
>
> (A) for the exclusive purpose of:
>
> (i) providing benefits to participants and their beneficiaries; and
>
> (ii) defraying reasonable expenses of administering the plan;
>
> (B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
>
> (C) *by diversifying the investments of the plan so as to minimize the risk of large losses,* unless under the circumstances it is clearly prudent not to do so; and

> (D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this subchapter and subchapter III of this chapter.

29 U.S.C. § 1104(a)(emphasis added); *see also DeBruyne v. Equitable Life Assur. Soc. of U.S.*, 920 F.2d 457, 465 (7 Cir.1990)(stating that in assessing whether "investment strategies were prudent, . . . the ultimate outcome of an investment is not proof of imprudence" and that "[t]he fiduciary duty of care, . . . requires prudence, not prescience"). A breach of fiduciary claim can only be brought against a fiduciary recognized under ERISA. *Baker v. Kingsley*, 387 F.3d 649, 660 (7 Cir.2004); *see also Bowerman v. Wal-Mart Stores, Inc.*, 226 F.3d 574, 590 (7 Cir.2000)(quoting 29 U.S.C. § 1104(a)(1) for the proposition that "[u]nder ERISA, a fiduciary must 'discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries'"). In regard to monitoring a plan's investments, a fiduciary has a general "duty of prudence." *Steinman v. Hicks*, 352 F.3d 1101, 1106 (7 Cir.2003).

We begin our analysis by noting a key fact. As Plaintiffs acknowledge, State Street was required by the Plan documents to invest the Plan funds in UAL stock. State Street could have sold the UAL stock sooner only if it chose to override the Plan's provisions based upon extraordinary circumstances. (Ans. St. SJ 1). If State Street had chosen to sell the UAL stock sooner and that decision proved to be premature, State Street would have breached its fiduciary duty to follow the directions of the Plan.

Appendix B

State Street was a directed trustee pursuant to 29 U.S.C. § 1103(a). As the court explained in *In re WorldCom, Inc. ERISA Litigation*, 354 F.Supp.2d 423 (S.D.N.Y.2005), a "directed trustee has no duty to investigate the wisdom of [investment] choices or any obligation to render advice regarding the choices" and the trustee's fiduciary duty is essentially to ensure that the actions of a plan are in compliance with ERISA. *Id.* at 449. Both State Street and Plaintiffs argue that the holding in *In re WorldCom, Inc.* supports a finding in their favor. (St. St. SJ 8)(Ans. St. St. SJ 3). We agree with the court's reasoning in *In re WorldCom, Inc.* that "a directed trustee's knowledge that a company's 'stock price and profits were declining and that the company was undergoing a restructuring' is not sufficient to find a breach of a fiduciary duty where the trustee continued to invest plan funds in the company's stock as directed." *Id.* (quoting *Lalonde v. Textron, Inc.*, 369 F.3d 1, 7 (1st Cir.2004)). The directed trustee can only be held accountable when failing to act upon reliable and trustworthy information. *Id.* n. 25. Such information generally consists of "public indicators" that show "an imminent collapse, as opposed to long-term indicators that could, for example, forecast a company's future obsolescence." *Id.* It is important that a directed trustee only be required to act upon reliable information that shows an imminent collapse because otherwise a fiduciary could be cajoled into prematurely selling off an employer's securities. The fiduciary, for all its caution, would not "maintain the investment in the employer's securities," and "it may face liability for that caution," especially if the collapse scare proves to be unfounded and ultimately the "employer's securities thrive." *Moench v. Robertson*, 62 F.3d 553, 572 (3 Cir.1995).

Appendix B

Plaintiffs' contention that Defendants should have sold UAL stock in October 2001 is mainly based upon a letter written by UAL CEO James Goodwin ("Goodwin letter"). Plaintiffs contend that the letter clearly showed that UAL was facing imminent financial collapse. However, State Street has provided ample evidence that indicates that during the fall of 2001, UAL was not facing imminent financial collapse. We are not, as Plaintiffs suggest, simply giving more weight to State Street's position because they have presented more expert opinions in their favor. Although the opinions of Morrison, Plaintiffs' expert, are unreliable to such an extent that they cannot be presented to the trier of fact, we have not simply accepted the veracity of State Street's expert opinions in default. Instead, we have thoroughly examined all of the opinions and conclusions of all of the experts, and have analyzed each of the expert's conclusions individually. The evidence presented by State Street is such that no reasonable trier of fact could conclude that UAL was facing imminent bankruptcy in October 2001. Our conclusions would not be altered even if we had considered Morrison's testimony and opinions. For instance, the evidence undeniably shows that UAL had a realistic expectation of receiving the grants and loan funds that it sought. The evidence also clearly shows that UAL had a strong cash position and the market indicators did not show that UAL was facing imminent bankruptcy.

Plaintiffs misquote the Goodwin letter in order to make their point that Goodwin was signaling that UAL's bankruptcy was imminent. Plaintiffs claim that Goodwin stated that UAL would "'perish next year' - which was then only 10 weeks away." (Ans. St. SJ 1). Plaintiffs thus assert that such a statement meant that in October 2001 the

bankruptcy was a few months away at the beginning of 2002. However, in actuality, Goodwin stated in his letter that UAL would "perish *some time* next year," which clearly indicates that any such problems could very easily have been far off in 2002. (Goodwin Let. 1)(emphasis added).

Also, Plaintiffs attempt to pull quotes from the Goodwin letter out of context. There is no indication that the letter was intended to provide an anticipatory notification of the inevitability of UAL's bankruptcy. Rather, the letter was clearly, as State Street refers to it, a "rallying call to the employees and the unions to come to the bargaining table, warning that if they did not, and various other events (such as obtaining a loan) did not occur, UAL [might] 'perish.'" (St. SJ Mem. 10). Nowhere in the Goodwin letter did Goodwin indicate that bankruptcy was imminent. Rather, Goodwin stated that UAL might ultimately perish down the road if certain issues were not addressed. This is clear, for example, by Goodwin's reference to the fact that if UAL did not succeed in certain areas, UAL would "*eventually* run out of money." (Goodwin Let. 1)(emphasis added). There is certainly no indication of imminent financial collapse from an assertion that there "eventually" may be such a collapse. The fact that Goodwin was not seeking to broadcast the inevitable financial collapse is also evident from the positive manner in which the letter is concluded: "The sooner we get to breakeven, the sooner we'll remove the doubts about our future." (Goodwin Let. 2).

State Street also correctly points out that the mere fact that the UAL stock price fell after terrorist attacks in September 2001, did not mean that UAL was doomed at that

point to financial collapse. There were sufficient indications that UAL could recover from its setbacks, and Plaintiffs now in hindsight unfairly seek to hold State Street accountable for not foreseeing the future and for failing to foresee UAL's ultimate filing of bankruptcy. Plaintiffs also attempt to hold State Street liable as an investment manager. State Street concedes for the purposes of its summary judgment motion that it became an investment manager as of August 2002. However, the evidence clearly shows that State Street began to sell UAL stock within one month of becoming the investment manager. The evidence also clearly shows that any delay on the part of State Street was part of a well thought out investigation to determine the best course of action, as required of any fiduciary.

Plaintiffs also seek to hold State Street liable as a co-fiduciary for violating the duties of prudence and loyalty pursuant to 29 U.S.C. § 1105(a), for enabling the Committee members to breach their fiduciary duties. However, the vast array of evidence in this case shows that UAL was not facing imminent bankruptcy in the fall of 2001 and that State Street, as a co-fiduciary of the Committee, did not breach its fiduciary duties. No reasonable trier of fact could find otherwise. Also, State Street reasonably believed that the Committee was fulfilling its fiduciary obligations. It was the Committee that had the primary responsibility of monitoring the investments in the Plan. It is undeniable, based upon the evidence, that the Committee members understood their fiduciary duties, including the need to diversify the Plan investments. Plaintiffs have not provided any evidence that shows that State Street representatives were present during the entirety of all of the Committee meetings or during all

discussions between Committee members and their advisors. Plaintiffs also admit pursuant to Local Rule 56.1 that in the fall of 2001, the Committee's own attorneys, Bonnie Levitt and Marian Durkin, "did not believe that UAL's bankruptcy was imminent, and did not believe it necessary to advise their clients to override the Plan." (R St. SF 61). Plaintiffs contend that State Street should have done more to provide the Committee with advice and information. However, State Street was not obligated to act as legal counsel for the Committee. In fact, the Committee had retained its own legal counsel. The evidence unquestionably shows that State Street fulfilled all of its obligations to ensure that the Committee understood its fiduciary duties and its ability to sell UAL stock and kept the Committee adequately informed. The evidence also clearly shows that State Street adequately monitored and evaluated the UAL stock.

Plaintiffs also contend that State Street knew that the Committee members were presented with conflicting loyalties. However, Plaintiffs have not pointed to sufficient evidence that would enable a reasonable trier of fact to conclude that State Street should have recognized any such conflicts or that any such conflicts actually existed. State Street did nothing more than acknowledge potential conflicts and Plaintiffs have attempted to create such conflicts when none existed. Finally, Plaintiffs complain about the fact that State Street did not notify the Committee that UAL was placed on State Street's internal watch list. However, we agree with State Street that such information did not have to be disclosed by State Street, and thus Plaintiffs' argument in that regard is nothing more than a red herring. The fact that UAL was on the watch list merely indicated that State Street

was closely monitoring UAL and did not mean that UAL was facing imminent bankruptcy. The evidence shows that the Committee knew that State Street monitored the UAL stock, and there is no evidence that State Street ever attempted to conceal its monitoring of that stock. Therefore, we grant State Street's motion for summary judgment. Also, based upon the above analysis and the evidence referred to above, we deny Plaintiffs' partial motion for summary judgment.

CONCLUSION

Based on the foregoing analysis, we grant State Street's motion for summary judgment and deny Plaintiffs' motion for partial summary judgment. We also grant State Street's motion to exclude Plaintiffs' expert opinions and testimony.

s/ Samuel Der-Yeghiayan
Samuel Der-Yeghiayan
United States District Court Judge

Dated: October 12, 2005

APPENDIX C — 29 U.S.C.S. § 1103

§ 1103. Establishment of trust

(a) Benefit plan assets to be held in trust; authority of trustees. Except as provided in subsection (b), all assets of an employee benefit plan shall be held in trust by one or more trustees. Such trustee or trustees shall be either named in the trust instrument or in the plan instrument described in section 402(a) [29 USCS § 1102(a)] or appointed by a person who is a named fiduciary, and upon acceptance of being named or appointed, the trustee or trustees shall have exclusive authority and discretion to manage and control the assets of the plan, except to the extent that—

(1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act, or

(2) authority to manage, acquire, or dispose of assets of the plan is delegated to one or more investment managers pursuant to section 402(c)(3) [28 USCS § 1102(c)(3)].

* * * *

APPENDIX D — 29 U.S.C.S. § 1104

§ 1104. Fiduciary duties

(a) Prudent man standard of care.

(1) Subject to sections 403(c) and (d), 4042, and 4044 [29 USCS § § 1103(c), (d), 1342, 1344], a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and—

(A) for the exclusive purpose of:

(i) providing benefits to participants and their beneficiaries; and

(ii) defraying reasonable expenses of administering the plan;

(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;

(C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

(D) in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with the provisions of this title and title IV.

(2) In the case of an eligible individual account plan (as defined in section 407(d)(3) [29 USCS § 1107(d)(3)]), the diversification requirement of paragraph (1)(C) and the prudence requirement (only to the extent that it requires diversification) of paragraph (1)(B) is not violated by acquisition or holding of qualifying employer real property or qualifying employer securities (as defined in section 407(d)(4) and (5) [29 USCS § 1107(d)(4) and (5)]).

* * * *

APPENDIX E — 29 U.S.C.S. § 1105

§ 1105. Liability for breach by co-fiduciary

(a) Circumstances giving to liability. In addition to any liability which he may have under any other provision of this part [29 USCS § § 1101 et seq.], a fiduciary with respect to a plan shall be liable for a breach of fiduciary responsibility of another fiduciary with respect to the same plan in the following circumstances:

(1) if he participates knowingly in, or knowingly undertakes to conceal, an act or omission of such other fiduciary, knowing such act or omission is a breach;

(2) if, by his failure to comply with section 404(a)(1) [29 USCS § 1104(a)(1)] in the administration of his specific responsibilities which give rise to his status as a fiduciary, he has enabled such other fiduciary to commit a breach; or

(3) if he has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach.

(b) Assets held by two or more trustees.

(1) Except as otherwise provided in subsection (d) and in section 403(a)(1) and (2) [29 USCS § 1103(a)(1) and (2)], if the assets of a plan are held by two or more trustees—

(A) each shall use reasonable care to prevent a co-trustee from committing a breach; and

(B) they shall jointly manage and control the assets of the plan, except that nothing in this subparagraph (B) shall preclude any agreement, authorized by the trust instrument, allocating specific responsibilities, obligations, or duties among trustees, in which event a trustee to whom certain responsibilities, obligations, or duties have not been allocated shall not be liable by reason of this subparagraph (B) either individually or as a trustee for any loss resulting to the plan arising from the acts or omissions on the part of another trustee to whom such responsibilities, obligations, or duties have been allocated.

(2) Nothing in this subsection shall limit any liability that a fiduciary may have under subsection (a) or any other provision of this part [29 USCS § § 1101 et seq.].

(3)(A) In the case of a plan the assets of which are held in more than one trust, a trustee shall not be liable under paragraph (1) except with respect to an act or omission of a trustee of a trust of which he is a trustee.

(B) No trustee shall be liable under this subsection for following instructions referred to in section 403(a)(1) [29 USCS § 1103(a)(1)].

* * * *

APPENDIX F — 29 U.S.C.S. § 1109

§ 1109. Liability for breach of fiduciary duty

(a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 411 of this Act [29 USCS § 1111].

(b) No fiduciary shall be liable with respect to a breach of fiduciary duty under this title if such breach was committed before he became a fiduciary or after he ceased to be a fiduciary.

APPENDIX G — 29 U.S.C.S. § 1132

§ 1132. Civil enforcement [Caution: See prospective amendment note below.]

(a) Persons empowered to bring a civil action. A civil action may be brought—

(1) by a participant or beneficiary—

(A) for the relief provided for in subsection (c) of this section, or

(B) to recover benefits due to him under the terms of his plan, to enforce his rights under the terms of the plan, or to clarify his rights to future benefits under the terms of the plan;

(2) by the Secretary, or by a participant, beneficiary or fiduciary for appropriate relief under section 409 [29 USCS § 1109];

(3) by a participant, beneficiary, or fiduciary (A) to enjoin any act or practice which violates any provision of this title or the terms of the plan, or (B) to obtain other appropriate equitable relief (i) to redress such violations or (ii) to enforce any provisions of this title or the terms of the plan;

(4) by the Secretary, or by a participant, or beneficiary for appropriate relief in the case of a violation of 105(c) [29 USCS § 1025(c)];

(5) except as otherwise provided in subsection (b), by the Secretary (A) to enjoin any act or practice which violates any provision of this title, or (B) to obtain other appropriate equitable relief (i) to redress such violation or (ii) to enforce any provision of this title;

(6) by the Secretary to collect any civil penalty under paragraph (2), (4), (5), (6), or (7) of subsection (c) or under subsection (i) or (l);

(7) by a State to enforce compliance with a qualified medical child support order (as defined in section 609(a)(2)(A) [29 USCS § 1169(a)(2)(A)]);

(8) by the Secretary, or by an employer or other person referred to in section 101(f)(1) [29 USCS § 1021(f)(1)], (A) to enjoin any act or practice which violates subsection (f) of section 101 [29 USCS § 1021(f)], or (B) to obtain appropriate equitable relief (i) to redress such violation or (ii) to enforce such subsection; or

(9) in the event that the purchase of an insurance contract or insurance annuity in connection with termination of an individual's status as a participant covered under a pension plan with respect to all or any portion of the participant's pension benefit under such plan constitutes a violation of part 4 of this title [subtitle] or the terms of the plan, by the Secretary, by any individual who was a participant or beneficiary at the time of the alleged violation, or by a fiduciary, to obtain appropriate relief, including the posting of security if necessary, to assure receipt by the participant or beneficiary of the amounts provided or to be provided by such insurance contract or annuity, plus reasonable prejudgment interest on such amounts.

* * * *

APPENDIX H — FIELD ASSISTANCE BULLETIN FROM THE U.S. DEPARTMENT OF LABOR, NO. 2004-03, DATED DECEMBER 17, 2004

U.S. Department of Labor

Employee Benefits Security Administration
Washington, D.C. 20210

FIELD ASSISTANCE BULLETIN NO. 2004-03

DATE: DECEMBER 17, 2004

MEMORANDUM FOR:
VIRGINIA C. SMITH,
DIRECTOR OF ENFORCEMENT
REGIONAL DIRECTORS

FROM: ROBERT J. DOYLE
DIRECTOR OF REGULATIONS
& INTERPRETATIONS

SUBJECT: FIDUCIARY RESPONSIBILITIES OF DIRECTED TRUSTEES

ISSUE: In the context of publicly traded securities, what are the fiduciary responsibilities of a directed trustee?

BACKGROUND

Many employee pension plans use directed trustees to carry out transactions according to instructions from a named fiduciary of the plan. During investigations of such transactions by the Department, difficult questions may arise

regarding the scope of the directed trustee's fiduciary duties. Recent court decisions, addressing this issue in the context of purchases and holdings of publicly traded employer securities in particular, have focused attention on the nature and scope of a directed trustee's fiduciary duties. This bulletin provides general guidance to EBSA regional offices regarding the Department's views on the responsibilities of directed trustees under ERISA, particularly with respect to directions involving employer securities.

FIDUCIARY STATUS OF DIRECTED TRUSTEE

Section 403(a) provides that a plan trustee "shall have exclusive authority and discretion to manage and control the assets of the plan." Section 3(21)(A) provides that a person is a fiduciary with respect to a plan "to the extent . . . he . . . exercises any authority or control respecting management or disposition of its assets." A plan trustee, therefore, will, by definition, always be a "fiduciary" under ERISA as result of its authority or control over plan assets. Not all trustees, however, have the same authority or discretion to manage or control the assets of a plan. In this regard, section 403(a) specifically recognizes that a trustee or trustees will have limited authority or discretion when:

> (1) the plan expressly provides that the trustee or trustees are subject to the direction of a named fiduciary who is not a trustee, in which case the trustees shall be subject to proper directions of such fiduciary which are made in accordance with the terms of the plan and which are not contrary to this Act.

Appendix H

While section 403(a)(1) does not remove a directed trustee from section 3(21)'s purview, it significantly limits such a trustee's responsibilities as a plan fiduciary. As the district court in *In re Enron Corp. Securities, Derivative & ERISA Litig.*, 284 F. Supp. 2d 511, 601 (S.D. Tex. 2003), recognized:

> At least some fiduciary status and duties of a directed trustee are preserved, even though the scope of its exclusive authority and discretion to manage and control the assets of the plan' has been substantially constricted by the directing named fiduciary's correspondingly broadened role . . . .

The court in *In re WorldCom, Inc. ERISA Litig.*, 263 F. Supp. 2d 745, 762 (S.D.N.Y. 2003) also noted that, while the directed trustee provision serves as a limiting principle, "section 403(a) does not ... eliminate the fiduciary status or duties that normally adhere to a trustee with responsibility over ERISA assets." *See also FirsTier Bank, N.A. v. Zeller*, 16 F.3d 907, 9110 (8th Cir.), cert. denied sub nom, *Vercoe v. FirsTier Bank, N.A.*, 513 U.S. 871 (1994); *Herman v. NationsBank Trust Co.*, 126 F.3d 1354, 1361-62, 1370 (11th Cir. 1997).

The duties of a directed trustee under section 403(a)(1) are therefore significantly narrower than the duties generally ascribed to a discretionary trustee under common law trust principles.[1]

---

1. It is assumed for purposes of this guidance that discretionary authority or control over plan assets, beyond that discussed herein as applicable to a person serving as a directed trustee under section 403(a)(1), has not been conferred upon a directed trustee under the terms of the plan, including trust and service provider agreements.

Appendix H

DETERMINING WHETHER A DIRECTION IS "PROPER"

Under section 403(a)(1), a directed trustee is subject to proper directions of a named fiduciary. For purposes of section 403(a)(1), a direction is proper only if the direction is "made in accordance with the terms of the plan" and "not contrary to the Act [ERISA]." Accordingly, when a directed trustee knows or should know that a direction from a named fiduciary is not made in accordance with the terms of the plan or is contrary to ERISA, the directed trustee may not, consistent with its fiduciary responsibilities, follow the direction.

In accordance with plan terms

Under section 403(a)(1), a directed trustee may not follow a direction that the trustee knows or should know is inconsistent with the terms of the plan. In order to make such determinations, directed trustees necessarily have a duty to request and review all the documents and instruments governing the plan that are relevant to its duties as directed trustee. Accordingly, if a directed trustee either fails to request such documents or fails to review the documents furnished in response to its request and, as a result of such failure, follows a direction contrary to the terms of the plan, the directed trustee may be liable for following such direction because the directed trustee had a duty to request and review pertinent plan documents and, therefore, should have known that the direction was not in accordance with the terms of the plan. If a directed trustee follows an improper direction, as would be the case where the purchase of a particular stock at the direction of the plan's named fiduciary is contrary to the plan's investment policy, the directed trustee may be liable

for a breach of its fiduciary duty to follow only proper directions.

It is the view of the Department that a direction is consistent with the terms of a plan if the documents pursuant to which the plan is established or operated do not prohibit the direction. It is also the view of the Department that if, in the course of reviewing the propriety of a particular direction, a directed trustee determines that the terms of the relevant documents are ambiguous with respect to the permissibility of the direction, the directed trustee should obtain a clarification of the plan terms from the fiduciary responsible for interpreting such terms in order to ensure that the direction is proper. In this regard, the directed trustee may rely on the interpretation of such fiduciary.

Not contrary to ERISA

Even when a direction is consistent with the terms of the plan, the direction may nonetheless fail to be a proper direction because it is contrary to ERISA. Under section 403(a)(1), a directed trustee may not follow a direction that the trustee knows or should know is contrary to ERISA. For example, the directed trustee cannot follow a direction that the directed trustee knows or should know would require the trustee to engage in a transaction prohibited under section 406 or violate the prudence requirement of section 404(a)(1). The following discussion further clarifies the duties of a directed trustee in this area.

Appendix H

Prohibited transaction determinations

A directed trustee must follow processes that are designed to avoid prohibited transactions. A directed trustee could satisfy its obligation by obtaining appropriate written representations from the directing fiduciary that the plan maintains and follows procedures for identifying prohibited transactions and, if prohibited, identifying the individual or class exemption applicable to the transaction. A directed trustee may rely on the representations of the directing fiduciary unless the directed trustee knows that the representations are false.

Prudence determinations

The named fiduciary has primary responsibility for determining the prudence of a particular transaction, whether the transaction involves buying, selling or holding particular assets. Accordingly, as the courts and the Department have long recognized, the scope of a directed trustee's responsibility is significantly limited. A directed trustee does not, in the view of the Department, have an independent obligation to determine the prudence of every transaction. The directed trustee does not have an obligation to duplicate or second-guess the work of the plan fiduciaries that have discretionary authority over the management of plan assets and does not have a direct obligation to determine the prudence of a transaction. *See In re WorldCom ERISA Litig.*, 263 F. Supp. 2d at 761; *Herman v. NationsBank Trust Co.*, 126 F.3d at 1361-62, 1371 (directed trustee does not have a direct obligation of prudence under ERISA section 404; its obligation is simply "to make sure" the "directions were

proper, in accordance with the terms of the plan, and not contrary to ERISA").

Duty to act on non-public information

The directed trustee's obligation to question market transactions involving publicly traded stock on prudence grounds is quite limited. The primary circumstance in which such an obligation could arise is when the directed trustee possesses material non-public information regarding a security. If a directed trustee has material non-public information that is necessary for a prudent decision, the directed trustee, prior to following a direction that would be affected by such information, has a duty to inquire about the named fiduciary's knowledge and consideration of the information with respect to the direction. For example, if a directed trustee has non-public information indicating that a company's public financial statements contain material misrepresentations that significantly inflate the company's earnings, the trustee could not simply follow a direction to purchase that company's stock at an artificially inflated price.

Generally, the possession of non-public information by one part of an organization will not be imputed to the organization as a whole (including personnel providing directed trustee services) where the organization maintains procedures designed to prevent the illegal disclosure of such information under securities, banking or other laws.[2] If, despite such

2. The Department expresses no view as to whether, or under what circumstances, other procedures established by an organization to limit the disclosure of information will serve to avoid the imputation of information to a directed trustee.

procedures, the individuals responsible for the directed trustee services have actual knowledge of material non-public information, the directed trustee, prior to following a direction that would be affected by such information, has a duty, as indicated above, to inquire about the named fiduciary's knowledge and consideration of the information with respect to the direction. Similarly, if the directed trustee performs an internal analysis in which it concludes that the company's current financial statements are materially inaccurate, the directed trustee would have an obligation to disclose this analysis to the named fiduciary before making a determination whether to follow a direction to purchase the company's security. The directed trustee would not have an obligation to disclose reports and analyses that are available to the public.

Duty to act on public information

Absent material non-public information, a directed trustee, given its limited fiduciary duties as determined by statute, will rarely have an obligation under ERISA to question the prudence of a direction to purchase publicly traded securities at the market price solely on the basis of publicly available information. Three considerations counsel in favor of this view: (1) markets generally are assumed to be efficient so that stock prices reflect publicly available information and known risks; (2) in the case of employer securities, the securities laws impose substantial obligations on the company, its officers, and its accountants to state their financial records accurately; and (3) ERISA section 404 requires the instructing fiduciary to adhere to a stringent

standard of care.[3] Furthermore, because stock prices fluctuate as a matter of course, even a steep drop in a stock's price would not, in and of itself, indicate that a named fiduciary's direction to purchase or hold such stock is imprudent and, therefore, not a proper direction.

In limited, extraordinary circumstances, where there are clear and compelling public indicators, as evidenced by an 8-K filing with the Securities and Exchange Commission (SEC), a bankruptcy filing or similar public indicator, that call into serious question a company's viability as a going concern,[4] the directed trustee may have a duty not to follow the named

---

3. It should be noted that, in the case of an individual account plan, the diversification requirements of section 404(a)(1)(C) do not apply to the acquisition or holding of qualifying employer securities within the meaning of section 407(d)(5).

4. We note that section 409 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. 78(m)(l), requires public companies to disclose "on a rapid and current basis" material information regarding changes in the company's financial condition or operations as the SEC by rule determines to be necessary or useful for the protection of investors or in the public interest. The SEC has recently updated its disclosure requirements related to Form 8-K, expanding the number of reportable events and shortening the filing deadline for most items to four business days after the occurrence of the event triggering the disclosure requirements of the form. 69 FR. 15594 (Mar. 25, 2004). Not all 8-K filings regarding a company would trigger a duty on the part of a directed trustee to question a direction to purchase or hold securities of that company. Only those relatively few 8-Ks that call into serious question a company's ongoing viability may trigger a duty on the part of the directed trustee to take some action.

fiduciary's instruction without further inquiry.[5] For example, if a company filed for bankruptcy under circumstances which make it unlikely that there would be any distribution to equity-holders, or otherwise publicly stated that it was unlikely to survive the bankruptcy proceedings in a manner that would leave current equity-holders with any value, the directed trustee would have an obligation to question whether the named fiduciary has considered the prudence of the direction.[6] It also is the view of the Department that, in situations where a fiduciary who is a corporate employee gives an instruction to buy or hold stock of his or her company subsequent to the company, its officers or directors, being formally charged by state or Federal regulators with financial irregularities, the directed trustee, taking such facts into account, may need to decline to follow the direction or may need to conduct an independent assessment of the transaction in order to assure itself that the instruction is consistent with ERISA.[7] If, however, an independent fiduciary was appointed

---

5. A directed trustee's actual knowledge of media or other public reports or analyses that merely speculate on the continued viability of a company does not, in and of itself, constitute knowledge of clear and compelling evidence concerning the company sufficient to give rise to a directed trustee's duty to act.

6. Even under such circumstances, it might not be imprudent to purchase or hold stock in a distressed company in bankruptcy. There may be situations in which the plan's fiduciaries could reasonably conclude that the stock investment makes sense, even for a long-term investor, in light of the proposed restructuring of the company's debts or other factors.

7. Nothing in the text should be read to suggest that a directed trustee would have a heightened duty whenever a regulatory body opens an investigation of a company whose securities are the subject of a direction, merely based on the bare fact of the investigation.

to manage the plan's investment in company stock, a directed trustee could follow the proper directions of the independent fiduciary without having to conduct its own independent assessment of the transaction.

EFFECT OF QUESTIONING DIRECTIONS ON FIDUCIARY STATUS

It is the view of the Department that the nature and scope of a directed trustee's fiduciary responsibility, as discussed herein, does not change merely because the directed trustee, in carrying out its duties, raises questions concerning whether a direction is "proper" or declines to follow a direction that the directed trustee does not believe is a proper direction within the meaning of section 403(a)(1). For example, information provided to a named fiduciary concerning the prudence of a direction is not investment advice for purposes of ERISA §3(21)(A)(ii). Similarly, if a named fiduciary changes a direction in response to a directed trustee's inquiries or information, the directed trustee's fiduciary responsibility with respect to the changed direction remains governed by section 403(a)(1). The directed trustee does not become primarily responsible for the prudence of the direction.

CO-FIDUCIARY DUTIES

Under ERISA section 405(a)(1), a fiduciary is liable for the breach of another fiduciary if the fiduciary "participates knowingly" in the breach of the other fiduciary. Accordingly, if a directed trustee has knowledge of a fiduciary breach, the directed trustee may be liable as a co-fiduciary unless the

directed trustee takes reasonable steps to remedy the breach. Thus, if the directed trustee knew that the named fiduciary was failing to discharge its obligations in accordance with ERISA's requirements, it could not simply follow directions from the breaching fiduciary. Efforts to remedy a breach (or to prevent an imminent breach) may include reporting the breach to other fiduciaries of the plan or the Department of Labor.

CONCLUSION

Although its responsibilities are significantly limited under the statute, a directed trustee is a fiduciary under ERISA and must exercise its duties prudently and solely in the interest of the plan participants and beneficiaries. Particularly in the context of purchasing, selling or holding publicly traded securities on a generally recognized market, the trustee may follow the named fiduciary's directions absent extraordinary circumstance as discussed above.